

The Evolving World of Cross-Border Frauds: Predicting What the Future Holds and How to Prepare for Same



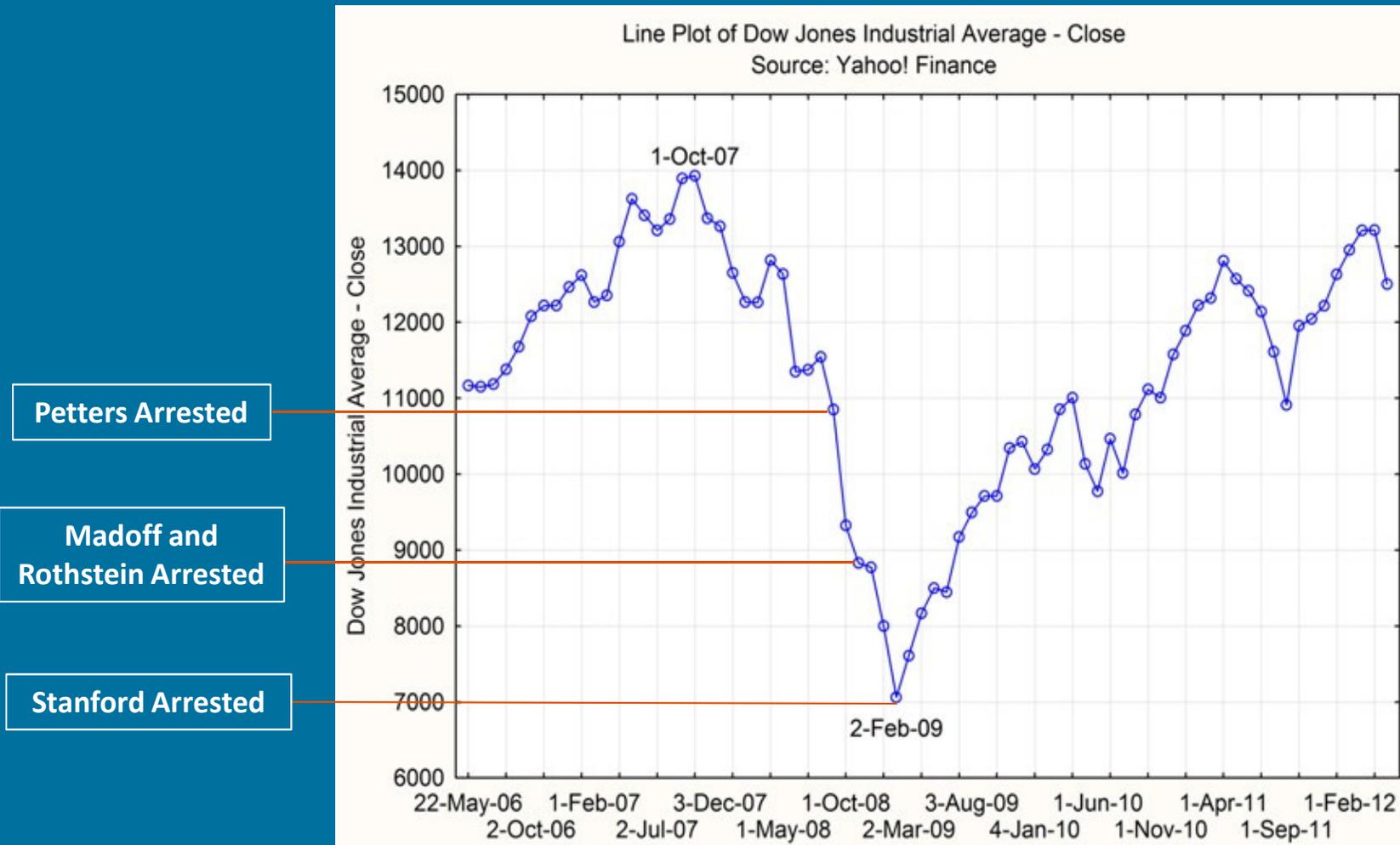
“How could I have done this? I was making a lot of money.”

-Bernie Madoff

This Is Not 2007-2008... Unfortunately

- Many of the large scale frauds that arose in connection with the recent economic collapse are well developed, closing down, or are now focused on select asset recovery efforts.
 - Madoff
 - Stanford
 - Petters
 - Rothstein
 - LeNature
 - Drier

The Dow Jones' Direction and Recent Massive Frauds



Fraud is Evolving as the US Economy Slowly Recovers

- "Fraud is very much attuned to the economic cycle." Peter Henning as quoted in Bloomberg Law's World Securities Law Report[™] ("Bloomberg")
- "Companies can keep questionable accounting practices from coming to the surface when they have enough sales/revenue to perpetuate their financial reporting decisions. However, in times of slowdown, accounting fraud surfaces because 'the shuffle cannot continue.'" Bloomberg
- With safer investments, there are reduced opportunities for large scale fraudsters such as Madoff and Stanford... at least until the markets get frothier.

Why the Economy Impacts Fraud

- With the recent economic recovery, and increased oversight and regulations, investors have been guarding against risky investments/loans, and the potential problems that more aggressive investment strategies often generate.

The European Recovery Faces More Challenges . . . and Risks

- "Europe's economy is making some progress, but growth remains too weak to save many deeply indebted companies."

Wall Street Journal Law Journal, 3/16/2014

- "The halting recovery hasn't produced many jobs, and companies are struggling with weak demand and the weight of bad investments made before the bust."

Wall Street Journal Law Journal, 3/16/2014

- With increased economic problems and resultant insolvencies, there is a likelihood that large scale frauds will be uncovered.

Potential Risks With Slowdown in China

- "The incidence of financial distress [in China] is rising and becoming more visible."

Financial Times, 3/19/2014

- "These are not random developments or bad luck, but connected parts of a complex economic transformation with deflationary consequences for the world economy and skittish financial markets."

Financial Times, 3/19/2014

Less High Profile Frauds in US

- "The number of new SEC actions filed in FY 2013 was lower than in previous years... 2013 'turned out to be the slowest year for new cases since 2006.'" [Bloomberg](#)
- "At one time, accounting fraud actions constituted 25 percent to 30 percent of SEC enforcement cases, reaching a peak of 219 cases in fiscal year 2007. Since that time, however, the number of SEC financial fraud cases has steadily decreased, reaching new lows of 79 actions in FY 2012 and 68 actions in FY 2013." [Bloomberg](#)
- "The Securities and Exchange Commission is deploying an innovative computerised tool designed to automatically trigger alerts concerning suspicious accounting at publicly traded companies"
[Financial Times, 2/13/2013](#)
- "Notwithstanding the billions of dollars in restitution, fines and litigation costs incurred to date by banks and securities firms globally, regulatory pressure is not expected to dissipate in 2014"
[Cso.com, 3/6/2014](#)

The Legacy of Reduced Fraud in the US

- Bingham McCutchen LLP attributed a drop in revenue of \$110 million in part to a slowdown in securities and financial services work.

Law360, 2/25/2014

- Patten Boggs LLP and Kasowitz Benson Torres & Freeman LLP laid off multiple attorneys after a slowdown in work related to SEC filings. A representative for Kasowitz claimed that, "The cuts were necessitated... by the end of financial crisis-triggered work."

Law360, 2/25/2014

Nevertheless, Large Scale Frauds Continue Today

- Citigroup, and its affiliate Banamex, are under investigation regarding \$400 million in fraudulent loans to an oil company owned by the Mexican Government.
- "The situation in Mexico is an echo of past problems in Latin America that saddled Citigroup with huge losses. In the 1980s, the bank was crippled by bad loans in the region." NY Times
- Governmental agencies from both the US and Mexico are investigating, including the FBI, the SEC, and the Mexican Attorney General.

Large Scale Frauds Continue Today

- Mt. Gox files for bankruptcy protection in Tokyo...
- Mt. Gox and Japanese investment bank Mizuho face lawsuits in America and Canada as the bitcoin exchange filed for Chapter 15 bankruptcy in Dallas, TX.
- The plaintiffs allege that Mt. Gox continued to fraudulently trade Bitcoins in their exchanges for two weeks after they lost \$567 million worth of assets and Bitcoins.

Large Scale Frauds Continue Today

- The FDIC is suing 16 banks throughout America, Europe, and Asia, alleging collusion and fraud with regards to the London Interbank Offered Rate ("LIBOR").
- "The FDIC alleges that collusion among the banks that set Libor rates interfered with the competitive process in the markets for money and Libor-based financial instruments. Their actions artificially increased the prices they charged and the margins they earned in those markets, according to the FDIC's complaint."

[USA Today, 3/14/2014](#)

Large Scale Frauds Continue Today

- Russian businessman Sergei Polonsky "was charged in absentia with fraud relating to a property firm he founded which is accused of stealing more than 5.7 billion roubles (\$172 million) from people who had prepaid for flats in a residential housing complex it was building."

[Reuters](#), 8/2/2013

- In January it was revealed that "A Cambodian court has freed [Polonsky]. The court also suspended extradition proceedings against him."

[Voanews.com](#), 1/13/2014

Large Scale Frauds Continue Today

- TelexFree, LLC
 - US Securities & Exchange Commission and state regulators filed charges against a Massachusetts telephone marketing company for allegedly running a pyramid scheme that targeted primarily Dominican and Brazilian immigrants.
 - According to the SEC complaint, the defendants sold securities in the form of TelexFree "memberships" that promised annual returns of 200% or more for those who recruited new members and placed advertisements on free ad sites. Estimated claims are \$1 billion.
 - The company had sales revenue of about \$1.3 million from August 2012 through March 2014, barely 1% of the more than \$1.1 billion needed to cover its promised payments to promoters, the SEC said.
 - TelexFree filed for Chapter 11 bankruptcy protection on April 13 in Nevada.
 - Venue of the bankruptcy was subsequently transferred to Massachusetts.

Fraud Continues To Be Pervasive

- "Economic crime remains a fundamental fact of life for every segment of the global business community."
PWC's 2014 Global Economic Crime Survey ("PWC")
- "More than one in three organisations report being victimized by economic crime." PWC
- "The incidence and costs of fraud rose markedly in the past year, in turn driving up companies' sense of vulnerability."
Kroll 2013/2014 Global Fraud Report ("Kroll")

Changing Scale and Scope of Fraud

- Only 8% of economic crimes last year had a relative financial impact of \$5 million or more, while all but 20% had an impact of less than \$1 million. PWC
- "Individual business also faced a more diverse range of threats: on average, those hit in the past year suffered 2.3 different types of fraud each, compared with 1.9 in 2012." Kroll

A Shift to Rapid Growth Markets?

- Between 2011 and 2014, the rate of economic crime in the "Emerging Eight" countries* increased 67% more than the global rate. PWC
- The perception of future corruption in North America and Western Europe was 11% and 16% respectively, but Latin America, the Middle East, Eastern Europe, and Africa all had perceived risks of 34% or higher. PWC
- "30% of respondents report that entering new, riskier markets has increased their exposure to fraud in the past year."

The Economist's Global Fraud Report 2013-2014 ("Economist")

- "You can expect more FCPA enforcement in 2014."

Wall Street Journal LawBlog, 12/31/2013

* Includes Brazil, China, India, Indonesia, Mexico, Russia, Turkey, and South Africa

Threats of Fraud in Emerging Markets

- "Moving into new markets, *into rapid-growth markets*, brings additional risk."

Ernst & Young's 12th Global Fraud Survey ("EY")

- "Businesses in these [rapid growth markets], are also seen to be more likely than those in mature markets to misrepresent their actual financial performance." EY
- The areas in which potential investors are most dissuaded for fear of fraud are Latin America, Central and Eastern Europe, and Africa. Kroll

And Let's Not Forget about China . . .

- China Solar Energy Holdings, Ltd. lost 93% of its stock value when three high ranking executives were detained by Chinese authorities under allegations of fraud. Bloomberg, 10/20/2013
- "The disappearance of China Solar Energy's directors and the fraud probe underscore investor concern that the business environment on the mainland is opaque and prone to corruption." Bloomberg, 10/20/2013
- "This is the reason why valuations of Chinese stocks are lower. The penalty on the mainland isn't harsh enough to stop executives from committing frauds."

Lewis Wan as quoted by Bloomberg, 10/20/2013

Fraud Is Evolving: Potential Risks of Cybercrime

- 48% of organizations perceive the risk of cybercrime to be increasing, while only 5% feel that the risk is decreasing. PWC
- "Cyber-attacks, more organised and more global, can lead to losses of trust and actual property."

cgma.org, 1/9/2014

- "As an even greater proportion of business activity becomes digital, the potential for economic and commercial damage grows with it." Kroll
- 90% of cybercrimes had an impact of less than \$1 million, and 76% had an impact of less than \$100 thousand.

Some Conclusions

- Large scale fraud continues to be a pervasive and continuing global issue.
- Significant and historic fraud cases related to the economic collapse are winding down.
- There is movement away from the enormous schemes and toward a wider breadth of tactics and targets.
- Fraud is a global issue, that poses a risk to both established markets and emerging ones.
- There is a noticeable growth of fraud in less developed, more rapidly developing markets.
- Some of the new tactics of fraud include the burgeoning growth of serious cybercrime and the use of crypto currencies.
- Fraud is here to stay, and the economic cycle will portend an increase of large scale fraud in the future.
- We need to be at the forefront of change and new developments.